

**Letter of Findings: 04-20130516
Gross Retail Tax
For the Years 2007 through 2010**

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.

ISSUE

I. Gross Retail Tax – Packaging Materials.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-4-1; IC § 6-2.5-5-9; IC § 6-2.5-5-9(a); IC § 6-8.1-5-1(c); Indiana Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dept. of State Rev. v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Indiana Dept. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); [45 IAC 2.2-5-16](#); [45 IAC 2.2-5-16\(a\)](#); [45 IAC 2.2-5-16\(d\)\(1\)](#).

Taxpayer argues that its purchases of various packaging materials are exempt from the gross retail tax.

II. Ten-Percent Negligence Penalty.

Authority: IC § 6-8.1-5-1(c); IC § 6-8.1-10-2.1(a)(3); IC § 6-8.1-10-2.1(a)(2); IC § 6-8.1-10-2.1(d); [45 IAC 15-11-2\(b\)](#); [45 IAC 15-11-2\(c\)](#).

Taxpayer maintains that the Department of Revenue should exercise its discretion to abate the ten-percent "negligence" penalty.

STATEMENT OF FACTS

Taxpayer develops, manufactures, sells, and distributes prescription pharmaceuticals. Taxpayer has an Indiana location.

The Department of Revenue ("Department") conducted an audit review of Taxpayer's sales tax and business records.

The audit resulted in the assessment of additional gross retail tax. Taxpayer disagreed with portions of the assessment and submitted a protest to that effect. An administrative hearing was conducted and this Letter of Findings results.

I. Gross Retail Tax – Packaging Materials.

DISCUSSION

During the course of its business, Taxpayer purchased various packaging materials which it uses to deliver pharmaceuticals. Taxpayer maintains the purchases are exempt.

Pursuant to IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. Retail transactions involve the transfer of tangible personal property. IC § 6-2.5-4-1. A complementary excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction. IC § 6-2.5-3-2.

Indiana law permits various exemptions from the gross retail (sales) tax. In this instance, IC § 6-2.5-5-9 provides: "(d) Sales of wrapping material and empty containers are exempt from the state gross retail tax if the person acquiring the material or containers acquires them for use as nonreturnable packages for selling the contents that the person adds."

The applicable companion regulation is found at [45 IAC 2.2-5-16\(a\)](#) which states:

The state gross retail tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and returnable containers containing contents sold in a sale constituting selling at retail and returnable containers sold empty for refilling.

The regulation goes on to state that, "To qualify for this exemption, nonreturnable wrapping materials and empty containers must be used by the purchaser in the following way: (A) The purchaser must add contents to the containers purchased; and (B) The purchaser must sell the contents added." [45 IAC 2.2-5-16\(d\)\(1\)](#).

Taxpayer maintains that its wrapping and packaging material qualify for the exemption found at IC § 6-2.5-5-9.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Indiana Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

In applying any tax exemption such as that sought here by Taxpayer, the general rule is that "tax exemptions

are strictly construed in favor of taxation and against the exemption." *Indiana Dept. of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). A statute which provides a tax exemption, therefore, is strictly construed against the taxpayer. *Indiana Dept. of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.* at 101. (citing *Conklin v. Town of Cambridge City*, 58 Ind. 130, 133 (Ind. 1877)).

Taxpayer has provided sufficient documentation to establish that its purchase of "Clear Wrap," pallet slipsheets, stretch film, and hand wrap, are exempt from sales/use tax because the items constitute "nonreturnable wrapping materials . . ." used to transport its pharmaceuticals to its various customers. However, the Department is unable to agree that Taxpayer has established that the "bubble wrap" is exempt because it is unclear if the bubble wrap functions as an "enclosure" or "container."

FINDING

Taxpayer's protest is sustained in part and denied in part.

II. Ten-Percent Negligence Penalty.

DISCUSSION

Taxpayer believes that it is entitled to abatement of the ten-percent negligence penalty because Taxpayer "has demonstrated the necessary ordinary business care to warrant the waiver of the ten percent negligence penalty." Taxpayer indicates that it timely filed "all their Indiana sales and use tax returns in a timely manner during the audit period" and that "it established use tax procedures to self assess use tax when the proper amount of sales tax is not charged on their purchase."

"Corporation was unclear on many of the issues raised by the audit." According to the "Audit Progress Report," the penalty was imposed because the "Taxpayer had no use tax self-assessment policy in place prior to [the] audit" and because "Taxpayer failed to remit use tax on all taxable purchases, where sales tax was not paid to the vendor."

IC § 6-8.1-10-2.1(a)(3) requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. IC § 6-8.1-10-2.1(a)(2) requires a ten-percent penalty if the taxpayer "fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment."

IC § 6-8.1-10-2.1(d) states that, "If a person subject to the penalty imposed under this section can show that the failure to . . . pay the full amount of tax shown on the person's return . . . or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall wave the penalty."

Departmental regulation [45 IAC 15-11-2\(b\)](#) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." *Id.*

Departmental regulation [45 IAC 15-11-2\(c\)](#) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . ."

Under IC § 6-8.1-5-1(c), "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." An assessment – including the negligence penalty – is presumptively valid.

Given the number of items for which taxpayer failed to self-assess use tax, and the fact that the taxpayer had no established internal procedure by which to self-assess use tax, the Department is unable to agree that the taxpayer exercised ordinary business care in determining its use tax liabilities.

The Department believes that taxpayer made substantial errors in determining its sales and use tax liability. However, there is insufficient information to establish that Taxpayer's actions constituted "willful neglect." Based on a "case-by-case" analysis and after reviewing "the facts and circumstances of each taxpayer" the Department agrees that the ten-percent negligence penalty should be abated.

FINDING

Taxpayer's protest is sustained.

SUMMARY

With the exception of "bubble wrap," Taxpayer's wrapping and packaging materials are exempt from sales and use tax. Taxpayer's "negligence" penalty will be abated.

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